



Federal Housing Finance Board

Performance and Accountability Report

Fiscal Year 2004

November 15, 2004

Message from the Chairman

I am pleased to present the fiscal year 2004 Performance and Accountability Report of the Federal Housing Finance Board (Finance Board), which provides stakeholders with meaningful financial and program performance information and summarizes the agency's success in meeting its fiscal year 2004 goals and objectives set forth in its fiscal year 2004 Annual Performance Plan.

The Finance Board is dedicated to providing timely, reliable and useful information to its stakeholders. To that end, the agency is especially pleased that this report, which combines reporting requirements for the U.S. Office of Management and Budget Circular A-123 and the Program Performance Report was produced for the first time within 45 days after the end of the fiscal year, the new financial reporting benchmark for all Cabinet-level agencies.

It was a productive year at the Finance Board. The agency met the goals established in the 2004 Annual Performance Plan. In addition, the Finance Board made substantial progress toward strengthening the agency and positioning it to carry out its responsibilities more efficiently and effectively in the future.

The Office of Inspector General of the Finance Board issued an unqualified opinion on the audit of the fiscal year 2004 financial statements, which are included in this report. This clean opinion attests to the fact that the agency's financial statements are fairly presented and demonstrate discipline and accountability in the execution of its responsibilities. This report also includes a statement of reasonable assurance that the Finance Board's management accountability and controls are adequate and effective.

The dedicated staff at the Finance Board will continue to work diligently to promote the safety and soundness of the Federal Home Loan Banks and build on the agency's accomplishments.

Alicia R. Castaneda
Chairman

Table of Contents

I.	Management Discussion and Analysis.....	3
	A. Agency at a Glance	3
	B. Performance Goals, Objectives, and Results	4
	C. Financial Highlights	8
	D. Management Accountability and Control	8
	E. Challenges	10
II.	Performance Results.....	11
III.	Audited Financial Statements.....	39

I. Management Discussion and Analysis

A. Agency at a Glance

The Federal Housing Finance Board

The Federal Housing Finance Board (Finance Board) is an independent federal agency established by the Financial Institutions Reform, Recovery, and Enforcement Act of 1989. The Finance Board is charged with supervising and regulating twelve Federal Home Loan Banks (FHLBanks) and has the statutory duty to ensure that the FHLBanks operate in a financially safe and sound manner, are adequately capitalized, and able to raise funds in the capital markets. The Finance Board also has the statutory duty to ensure that the FHLBanks carry out their housing finance mission.

The Finance Board is the successor to the former Federal Home Loan Bank Board (FHLBB), which was established by the Federal Home Loan Bank Act (FHLBank Act). The Finance Board's board of directors comprises five members. Four of the directors are appointed by the President and confirmed by the Senate and must have extensive experience or training in housing finance or a commitment to providing specialized housing credit. The fifth member is the Secretary of the U.S. Department of Housing and Urban Development. Not more than three directors can be from the same political party. At least one appointed director must be from an organization with more than a two-year history of representing consumer or community interests in banking services, credit needs, housing, or financial consumer protections. The appointed members of the Board of Directors serve staggered seven-year terms. The President designates the chairperson of the Board of Directors from among these appointed members.

The Finance Board draws its financial resources from assessments on the twelve FHLBanks. It receives no appropriations and its funds are not subject to apportionment.

Mission Statement

The mission of the Finance Board is to ensure that the FHLBanks are safe and sound so they can serve as a reliable source of liquidity and funding for the nation's housing finance and community investment needs.

Vision and Values

Vision: To continue to earn the public's trust, the Finance Board is dedicated to the highest professional standards of accountability and independence to carry out its responsibilities for FHLBank supervision and housing finance mission oversight.

Values: The core values underlying the mission and vision of the Finance Board, which guide its organizational decisions and actions, are:

- **Independence.** The Finance Board is the arm's-length regulator of the FHLBanks and Office of Finance (OF) of the FHLBanks.

- **Accountability.** The Finance Board is a steward of the public's trust and will use its resources efficiently and in the public interest.
- **Responsiveness.** The Finance Board aligns its actions with its mission and responds promptly, effectively, and creatively to emerging risks and opportunities in the financial system.
- **Integrity.** The Finance Board discharges its responsibilities fairly and impartially and adheres to the highest standards of ethical conduct.
- **Excellence.** The Finance Board strives for excellence in carrying out its responsibilities and recognizes the contributions of employees who demonstrate the highest professional standards in their work.

B. Performance Goals, Objectives and Results

2004 Performance Results

The Finance Board has identified three strategic goals that support the agency's achievement of its mission, as well as seven strategic objectives that provide a framework for the achievement of that mission. These strategic goals and objectives are described below, together with the agency's performance in achieving them in fiscal year 2004.

STRATEGIC GOAL 1: THE FEDERAL HOUSING FINANCE BOARD'S PROGRAM OF BANK SUPERVISION FOSTERS SAFE AND SOUND OPERATIONS AT EACH OF THE FEDERAL HOME LOAN BANKS

The Finance Board seeks to maintain a program of supervision that fosters safe and sound operations at each of the FHLBanks as well as OF. The Finance Board has identified three strategic objectives that provide a framework for the implementation of the agency's FHLBank safety and soundness strategic goal: (a) the FHLBanks operate safely and soundly; (b) the FHLBanks meet or exceed their minimum capital requirements; and (c) the FHLBanks raise funds in the capital markets efficiently and are role models for corporate transparency and accountability.¹

Strategic Objective 1.1: The Federal Home Loan Banks Operate Safely and Soundly

In fiscal year 2004, the Finance Board achieved all of its annual performance goals relating to its safety and soundness program for the FHLBanks. The agency's progress in completing its annual cycle of on-site safety and soundness examinations of the twelve FHLBanks and OF was within the expectations of agency management, with completion of the cycle expected by calendar year-end 2004. At September 30, 2004, the agency had completed examinations of nine FHLBanks; the agency expects to complete its examination of the remaining three FHLBanks and OF by calendar year-end 2004. During these examinations and in periodic follow-up discussions with FHLBank

¹ The Finance Board has developed annual performance goals and measures in connection with each strategic goal identified in Part I. Those annual performance goals and measures are discussed in Part II of this document.

management between examinations, agency staff assessed the effectiveness of corrective actions, if any, it required to be undertaken by these institutions and, where warranted, required further corrective actions. The agency continued to provide market risk measurement and modeling support in connection with these examinations and conduct ongoing off-site monitoring of the condition and performance of, and regulatory compliance by, the FHLBanks, as well as market developments affecting them. Improvements to the supervisory process initiated or continued by the Finance Board in fiscal year 2004 included the preparation and field-testing of revisions and updates to its manual of examination, the commencement of development of a FHLBank-wide risk assessment framework for evaluation of the FHLBanks, and the preparation and distribution of supervisory guidance to agency examiners.

Strategic Objective 1.2: The Federal Home Loan Banks Meet or Exceed Their Minimum Capital Requirements

During the calendar year 2004 examination cycle, the Finance Board assessed the compliance of the nine FHLBanks examined by September 30 with applicable capital requirements together with the adequacy and effectiveness of their capital management policies; the agency expects to conduct such assessments for the three remaining FHLBanks as part of the examinations scheduled to occur by calendar year-end 2004. During fiscal year 2004, the agency also conducted monthly off-site monitoring of the capital of all twelve FHLBanks.

As of September 30, 2004, nine FHLBanks had implemented their capital structure plans mandated by Section 6 of the FHLBank Act and the agency's regulations. Prior to that date, the agency had approved the market risk models or cash-flow models and risk assessment and control procedures of these institutions and of one other FHLBank that had not implemented its capital structure plan. In 2004, the Finance Board assessed the continuing adequacy of such models and procedures of eight of these ten FHLBanks during its annual on-site examinations; the agency expects to conduct such assessments of the remaining two FHLBanks by calendar year-end 2004. For one of the two remaining FHLBanks that have neither implemented their capital structure plans nor received approval of their market risk or cash-flow models and risk assessment and control procedures, the Finance Board assessed the progress of the institution with respect to its development of these models and procedures; the agency expects to conduct such an assessment of the second such FHLBank by calendar year-end 2004. The Board of Directors of the Finance Board has considered four requests by FHLBanks to amend their capital structure plans in 2004.

Strategic Objective 1.3: The Federal Home Loan Banks Raise Funds in the Capital Markets Efficiently and Are Role Models for Corporate Transparency and Accountability

During fiscal year 2004, the Finance Board achieved its annual performance goals designed to ensure that the Federal Home Loan Bank System (System) continues to be able to raise funds in the capital markets at the lowest possible cost. First, the agency conducted comparisons of the System's cost of funds relative to those of the U.S. Department of the Treasury (Department of the Treasury) and those of other government sponsored enterprises engaged in housing-related activities twice in fiscal year 2004. Second, the agency continued to monitor compliance by the FHLBanks with the agency's

requirement that the institutions maintain the highest credit rating from a Nationally Recognized Statistical Rating Agency (NRSRO) on their consolidated obligations, as well as at least the second highest individual issuer credit rating on each FHLBank, as an individual issuer, where such rating is a meaningful measure of the FHLBank's financial strength and is updated at prescribed intervals.

In fiscal year 2004, the Finance Board achieved its annual performance goals designed to ensure that System combined financial reporting and financial reporting by individual FHLBanks, as well as the sale of System consolidated obligations, complied with disclosure and customer suitability requirements contained in the Finance Board's regulations. First, the agency reviewed the annual and quarterly combined System-wide financial reports (Bank System Financial Reports) issued by OF, as well as annual and quarterly financial reports prepared and issued by each of the FHLBanks, for compliance with the disclosure requirements of its regulations. Second, the agency conducted an on-site examination of OF to assure the latter's ability to carry out its prescribed functions in accordance with the agency's regulations. OF's operations and corporate governance practices were also reviewed.

The Finance Board adopted a final rule in June 2004 that requires each FHLBank to register a class of its equity securities with the Securities and Exchange Act of 1934. Registration statements are to be filed with the U.S. Securities and Exchange Commission (SEC) by June 30, 2005, and declared effective no later than August 29, 2005. This furthers the Finance Board's objective of ensuring that the FHLBanks remain models of corporate transparency and accountability.

**STRATEGIC GOAL 2: THE FEDERAL HOUSING FINANCE BOARD
ENSURES THAT THE FEDERAL HOME LOAN
BANKS SERVE THE NATION'S HOUSING
FINANCE AND COMMUNITY INVESTMENT
NEEDS**

The Finance Board seeks to ensure that the FHLBanks serve the nation's housing finance and community investment needs. The Finance Board has identified two strategic objectives that provide a framework for the implementation of the agency's FHLBank housing mission strategic goal: (a) the FHLBanks facilitate the housing finance activities of their members and (b) the FHLBanks support affordable housing and promote community investment.²

During fiscal year 2004, the Finance Board achieved all of its annual performance goals relating to ensuring that the FHLBanks facilitate the housing finance activities of their members, support affordable housing, and promote community development. The Finance Board completed its review of the advance portfolios and the acquired member asset (AMA) programs and loan portfolios of nine FHLBanks as part of its on-site safety and soundness examinations in calendar year 2004 and will review the advance portfolios and AMA program and loan portfolios of the remaining three FHLBanks by calendar year-end 2004. The agency also conducted off-site monitoring of the size and composition of the advance portfolios of the FHLBanks and analyzed certain information received from the FHLBanks as to the geographic distribution and performance status of

² *Id.*

AMA loans over time and as to the demographic characteristics of AMA program loan borrowers.

The Finance Board completed full-scope or limited-scope, on-site, housing mission examinations of the Affordable Housing Program (AHP), Community Investment Program (CIP), and, as applicable, other Community Investment Cash Advance (CICA) programs, of seven FHLBanks by September 30, 2004. The agency will conduct limited scope examinations of the AHP, CIP, and, as applicable, other CICA programs, of the remaining five FHLBanks by calendar year-end 2004. During these examinations and periodic follow-up discussions between examinations, agency staff assessed the effectiveness of corrective actions it required to be undertaken by the FHLBanks and, where warranted, required further corrective action.

In fiscal year 2004, the Finance Board completed its review of the community lending plans of the twelve FHLBanks, as well as, the community support statements of 1,923 FHLBank members. The agency will complete its review of the community support statements of an additional 674 FHLBanks by calendar year-end 2004. The agency restricted FHLBank member access to long-term advances on seven occasions in fiscal year 2004 for failure to adhere to the agency's regulations. The agency also appointed or reappointed, as the case may be, public interest directors, including community interest directors, for vacancies on the boards of directors of the FHLBanks occurring at the end of calendar year 2003.

**STRATEGIC GOAL 3: THE FEDERAL HOUSING FINANCE BOARD'S
SUPERVISORY, MANAGERIAL, AND LEGAL
RESOURCES SUPPORT EFFECTIVE, EFFICIENT,
AND RESPONSIVE BANK SUPERVISION AND
REGULATION AND HOUSING OVERSIGHT**

The Finance Board seeks to align its supervisory, managerial, and legal resources to support effective, efficient, and responsive bank supervision and regulation and housing oversight. The Finance Board has identified two strategic objectives that provide a framework for the implementation of the agency's strategic administrative goal: (a) the Finance Board takes appropriate and timely regulatory and advisory actions and (b) the Finance Board makes prudent resource management allocations in order to fulfill its mission effectively and efficiently.³

During fiscal year 2004, the Finance Board achieved its annual performance goals relating to its ongoing efforts to review, revise, and supplement its regulations, issue supervisory guidance, and review and act upon new business activity notifications submitted by the FHLBanks promptly and comprehensively. The agency continued to review its regulations to ensure the consistency of these with the agency's risk-focused regulatory and supervisory program and priorities and, as previously noted, adopted a final rule requiring each FHLBank to register a class of equity securities with the SEC. The agency also continued to develop and issue anticipatory, results-oriented supervisory guidance to the FHLBanks in such areas as risk assessment and management, corporate governance, financial reporting and disclosure, safety and soundness findings categories, liability exposure resulting from state predatory lending laws, and FHLBank capital

³ *Id.*

management and retained earnings. The agency also processed three new business activity notifications in accordance with its regulations.

In fiscal year 2004, the Finance Board achieved its annual performance goals relating to the recruitment, retention, and development of high-achieving professional staff and the maintenance of appropriate contingency planning. The agency recruited forty additional staff members, including examiners, economists, accountants, and other professional staff. The agency also developed, reviewed, and updated its business continuity plan.

C. Financial Highlights

The total agency budget for fiscal year 2004 was approximately \$31.1 million, which exceeded the fiscal year 2003 budget by over \$4 million or 15 percent. The \$4.0 million budget increase reflected the net effect of shifting agency resources to more fully support the Finance Board's supervisory program. In addition, the agency allocated funds for new financial risk models and programming efforts for applications that exceed the fiscal year 2003 budget by \$1.5 million.

The fiscal year 2004 budget also included the impact of an information technology contract that outsourced much of the information technology support function for the agency and resulted in the reduction of information technology staff from nine positions a year ago to 2.9 positions for fiscal year 2004.

A summary of major contributors to the change in budget from fiscal year 2003 to 2004 include:

- Approximately \$4.3 million increase related to the strengthening of the Finance Board's supervisory program. Cost increases reflect new positions plus new, more powerful financial risk models and programming support.
- Over \$970,000 increase related to the renovation of the agency's headquarters building.
- A \$322,000 decrease related to the outsourcing of information technology support. Outsourcing contracts costs are offset by the elimination of various information technology costs, including help desk and information technology equipment/software costs, and by the elimination of positions.
- An \$833,000 decrease in salaries and benefits reflecting non-recurring 2003 separation and severance costs paid to former employees. Savings from eliminating these eleven positions are more than \$1.5 million.

D. Management Accountability and Control

In accordance with applicable requirements of 31 U.S.C. § 3512, and Office of Management and Budget (OMB) Circular A-123 (rev. June 21, 1995), the Finance Board provides this statement of reasonable assurance that the Finance Board's management accountability and controls are adequate and effective. The objectives of the system of management accountability and control of the Finance Board are to provide reasonable assurance that:

- Programs achieve their intended results;

- Resources are used in a manner consistent with agency mission;
- Programs and resources are protected from waste, fraud and mismanagement;
- Laws and regulations are followed; and
- Reliable and timely information is obtained, maintained, reported, and used for decision-making.

The concept of reasonable assurance recognizes that the cost of management control should not exceed the benefits expected to be gained, and that the benefits consist of reductions in the risks of failing to achieve the stated objectives. Estimates and judgments are required to assess the expected benefits and related costs of control procedures. Furthermore, errors or irregularities may occur and not be detected because of inherent limitations in any system of management accountability and control, including those limitations resulting from resource constraints and other factors. The statement of assurance and determination are based on the following:

- An independent outside audit of the Finance Board's financial statements, which provided an unqualified opinion and found no weaknesses involving the Finance Board's internal control structure determined to be material.
- An internal evaluation that included input from senior program and management officials and the Office of Inspector General (OIG) of the Finance Board, covering the period from October 1, 2003, through September 30, 2004, which concluded that the Finance Board's management accountability and controls are achieving their intended objectives.
- Comments of the OIG regarding the internal evaluation process and the Finance Board's management accountability and controls.

The Finance Board is committed to a strong internal control program. To that end, in September 2004, the Finance Board issued new guidance in the form of a policy document – Internal Control and Risk Management Policy. The purpose of the document is to establish policy and responsibilities for the development, implementation, evaluation, and reporting of Finance Board internal control and risk management programs. The Finance Board policy was developed and documented to implement cost-effective internal controls that achieve internal control objectives and manage risk. The establishment and implementation of effective risk assessment practices, if implemented appropriately, will reasonably ensure that the agency operates in an environment conducive to strong internal controls and that such controls are an integral part of the agency's on-going operations and management.

The Finance Board will continue to employ sound financial management techniques and emphasize the importance of a strong risk management and internal control program to meet its statutory, regulatory, and fiduciary responsibilities.

E. Challenges

Key External Factors

As is the case with all financial institution regulators, the Finance Board is affected by macroeconomic conditions. The Finance Board cannot control such factors as the capital markets, interest rates, regional or national recessions or economic expansions, housing prices, financial industry consolidation and restructuring, or banking policies formulated beyond its own jurisdiction.

The ability of the FHLBanks to provide funds to their members by issuing consolidated obligations can be affected by such factors as adverse movements in the international capital markets (such as a major foreign crisis), developments affecting the other government-sponsored enterprises, political factors, and unforeseen events. The FHLBanks' consolidated obligations must compete against such alternative investments as securities issued by the Department of the Treasury, other government-sponsored enterprises, and foreign or domestic corporate issuers.

The FHLBanks operate in an environment characterized by changing financial markets. With the advent of the revolutionary changes in information technology, financial markets move more rapidly than ever before. In recent years, the role of the FHLBanks as financial intermediaries has changed considerably and has grown in complexity as innovative financial products and risk management techniques are used to improve the management and control of risks. Moreover, consolidation of the financial services industry has presented challenges to the System as it has realigned the System's membership base.

In a competitive financial services environment where highly-skilled personnel are in great demand, a key challenge for the Finance Board will be to retain a highly-competent work force and, as needs dictate, to attract additional highly-qualified bank examination and supervision staff with the requisite financial and technological skills to model, monitor, and assess the risks undertaken by the FHLBanks. The Finance Board will also need to evaluate on an ongoing basis the reliability of its own and the FHLBanks' financial models to assure that they adequately measure the FHLBanks' market risk.

OIG's Management and Performance Challenges Facing the Finance Board

Below is the Finance Board's most significant management and performance challenge as identified by the OIG:

Challenge

Reducing the Security Vulnerabilities of the PeopleSoft Financial System.

Brief Description

Progress on this challenge is good. Agency management acknowledges the need to analyze the vulnerabilities in the PeopleSoft Financial System and is initiating corrective actions. A management goal has been established to resolve this issue by the end of fiscal year 2005.

Agency Response

Overall, the agency management agrees with the need to improve controls. The Finance Board plans to move to a new financial system (either upgrading or migrating) during fiscal year 2005. This will resolve the weaknesses identified by the auditors including security activation, third party security package, and user account and passwords changes.

II. Performance Results

Fiscal Year 2004 and 2005 Strategic and Annual Performance Planning

On October 1, 2004, the Finance Board submitted three documents to OMB, and subsequently to the persons required in Section 210(c) of Circular A-11 of OMB (Circular A-11), in satisfaction of the requirements of Sections 3 and 4 of the Government Performance and Results Act of 1993 and Part 6 of Circular A-11. These included:

- a) A strategic plan for fiscal years 2003 through 2008, amended and updated through August 31, 2004 (Strategic Plan);
- b) An annual performance plan for fiscal year 2004 as of August 31, 2004 (2004 Annual Performance Plan); and
- c) An annual performance budget for fiscal year 2005 as of August 31, 2004 (2005 Annual Performance Budget).

The Strategic Plan identifies three major strategic goals that drive the Finance Board's activities and operations: maintaining a program of bank supervision that fosters safe and sound operation at each of the FHLBanks, ensuring that the FHLBanks serve the nation's housing finance and community investment needs, and aligning the agency's supervisory, managerial, and legal resources to support effective, efficient, and responsive bank supervision and regulation and housing mission oversight. The Strategic Plan also identifies seven strategic objectives in furtherance of these strategic goals: (a) the FHLBanks operate safely and soundly; (b) the FHLBanks meet or exceed their minimum capital requirements; (c) the FHLBanks raise funds in the capital markets efficiently and are role models for corporate transparency and accountability; (d) the FHLBanks facilitate the housing finance activities of their members; (e) the FHLBanks support affordable housing and promote community investment; (f) the Finance Board takes appropriate and timely regulatory and supervisory actions; and (g) the Finance Board makes prudent resource allocations in order to fulfill its mission effectively and efficiently.

The 2004 Annual Performance Plan and 2005 Annual Performance Budget enumerate sixteen annual performance goals and nineteen performance measures. Through these, the Finance Board implemented in fiscal year 2004, and is implementing in fiscal year 2005, the strategic goals and objectives identified in the Strategic Plan. The annual performance goals and measures, together with the strategic goals and objectives to which they relate, are set forth on the next page.

STRATEGIC GOAL 1:

**THE FEDERAL HOUSING FINANCE BOARD'S PROGRAM OF BANK SUPERVISION
FOSTERS SAFE AND SOUND OPERATIONS AT EACH OF THE FEDERAL HOME
LOAN BANKS**

STRATEGIC OBJECTIVES:

Strategic Objective 1.1: The Federal Home Loan Banks Operate Safely and Soundly

Annual Performance Goal 1.1a:

Maintain Effective Risk-Based Supervisory Program, Including the: Conduct of Annual Safety and Soundness Examinations of the Twelve FHLBanks; Provision of Enhanced Examiner Guidance and Training; and Conduct of Off-Site Monitoring and Analysis of Their Condition, Annual Testing of Their Interest Rate Sensitivity, and Periodic Testing of Their Market Risk Models

Annual Performance Measure 1.1aa:

Complete Annual Safety and Soundness Examinations of the Twelve FHLBanks; Provide Enhanced Examiner Guidance and Training; and Conduct Off-Site Monitoring and Analysis of Their Condition, Annual Testing of Their Interest Rate Risk Sensitivity, and Periodic Testing of Their Market Risk Models

Annual Performance Goal 1.1b:

Apply Statutory, Regulatory, and Other Remedies in Response to Supervisory Concerns

Annual Performance Measure 1.1bb:

Assess Effectiveness of Required Corrective Actions at On-Site Safety and Soundness Examinations and at Reviews Conducted Quarterly or at More Frequent Intervals

***Strategic Objective 1.2: The Federal Home Loan Banks Meet or Exceed Their Minimum
Capital Requirements***

Annual Performance Goal 1.2a:

Each FHLBank Meets or Exceeds its Applicable Minimum Capital Requirement on a Continuous Basis

Annual Performance Measure 1.2aa:

Each FHLBank Satisfies Its Applicable Capital Requirements and Prudently Manages Its Capital and Earnings

Annual Performance Goal 1.2b:

Each FHLBank Implements or Makes Progress In Implementing Its Capital Structure Plan

Annual Performance Measure 1.2bb:

Conduct Review of Proposed FHLBank Market Risk or Cash-Flow Models and Risk Assessment Procedures and Controls, and Proposed FHLBank Capital Structure Plan Amendments

Strategic Objective 1.3: The Federal Home Loan Banks Raise Funds in the Capital Markets Efficiently and Are Role Models for Corporate Transparency and Accountability

Annual Performance Goal 1.3a:

Conduct Assessment of Cost of Funds and Ratings of FHLBank System Consolidated Obligations and Individual FHLBanks by NRSROs

Annual Performance Measure 1.3aa:

Conduct Semi-Annual Assessment of FHLBank System Cost of Funds

Annual Performance Measure 1.3aaa:

Monitor Compliance by FHLBanks with Finance Board Requirement of Minimum Ratings by NRSROs

Annual Performance Goal 1.3b:

Assess Compliance of FHLBanks and FHLBank System Financial Reporting and FHLBank Consolidated Obligations Sales with the Disclosure and Customer Suitability Requirements of the Finance Board's Regulations

Annual Performance Measure 1.3bb:

Conduct Review of Annual and Quarterly FHLBank System Combined Financial Reports and Financial Reports Issued by Individual FHLBanks for Compliance with the Disclosure Requirements of the Finance Board's Regulations

Annual Performance Measure 1.3bbb:

Conduct Annual On-Site Examination of OF

STRATEGIC GOAL 2:

THE FEDERAL HOUSING FINANCE BOARD ENSURES THAT THE FHLBANKS SERVE THE NATION'S HOUSING FINANCE AND COMMUNITY INVESTMENT NEEDS

STRATEGIC OBJECTIVES:

Strategic Objective 2.1: The Federal Home Loan Banks Facilitate the Housing Finance Activities of Their Members

Annual Performance Goal 2.1a:

Conduct Review of Advance Portfolio of Each FHLBank as Part of Annual On-Site Safety and Soundness Examination

Annual Performance Measure 2.1aa:

Complete Review of Advance Portfolio of Each FHLBank as Part of Annual On-Site Safety and Soundness Examination

Annual Performance Goal 2.1b:

Conduct Review of AMA Portfolio of Each FHLBank as Part of Annual On-Site Safety and Soundness Examination

Annual Performance Measure 2.1bb:

Complete Review of AMA Portfolio of Each FHLBank as Part of Annual On-Site Safety and Soundness Examination

Strategic Objective 2.2: The Federal Home Loan Banks Support Affordable Housing and Promote Community Investment

Annual Performance Goal 2.2a:

Conduct Annual On-Site Examination of the AHP, CIP and, as Applicable, Other CICA Programs, of each FHLBank

Annual Performance Measure 2.2aa:

Complete Annual On-Site Examination of the AHP, CIP and, as Applicable, Other CICA Programs, of Each FHLBank

Annual Performance Goal 2.2b:

Apply Statutory, Regulatory, and Other Appropriate Remedies in Response to Identified Agency Concerns

Annual Performance Measure 2.2bb:

Assess Effectiveness of Required Corrective Actions at On-Site Examinations or at Periodic Follow-Up Reviews

Annual Performance Goal 2.2c:

Conduct Annual Review of FHLBank Community Lending Plans and Biennial Review of FHLBank Member Community Support Statements

Annual Performance Measure 2.2cc:

Complete Annual Review of FHLBank Community Lending Plans and Biennial Review of FHLBank Member Community Support Statements

Annual Performance Goal 2.2d:

Carry Out Statutory Duty to Appoint Public Interest Directors, Including Community Interest Directors, to the Board of Directors of Each FHLBank

Annual Performance Measure 2.2dd:

Appoint Public Interest Directors, Including Community Interest Directors, to the Board of Directors of Each FHLBank

**STRATEGIC GOAL 3:
THE FEDERAL HOUSING FINANCE BOARD'S SUPERVISORY, MANAGERIAL,
AND LEGAL RESOURCES SUPPORT EFFECTIVE, EFFICIENT, AND RESPONSIVE
BANK SUPERVISION AND REGULATION AND HOUSING OVERSIGHT**

STRATEGIC OBJECTIVES:

***Strategic Objective 3.1: The Federal Housing Finance Board Takes Appropriate and Timely
Regulatory and Advisory Actions***

Annual Performance Goal 3.1a:

Review, Revise, and Supplement Finance Board
Regulations to Ensure Relevance and Transparency and
Issue Results-Oriented Supervisory Guidance

Annual Performance Measure 3.1aa:

Conduct Review of Finance Board Regulations and Revise
and Supplement These Where Appropriate

Annual Performance Measure 3.1aaa:

Issue Results-Oriented Supervisory Guidance

Annual Performance Goal 3.1b:

Review and Act Upon New Business Activity Notifications
by FHLBanks Promptly and Comprehensively

Annual Performance Measure 3.1bb:

Respond to New Business Activity Notifications by FHLBanks
within Sixty Days of Receipt

***Strategic Objective 3.2: The Federal Housing Finance Board Makes Prudent Resource
Management Allocations in Order to Fulfill Its Mission Effectively
and Efficiently***

Annual Performance Goal 3.2a:

Recruit, Retain, and Develop High-Achieving Professional Staff

Annual Performance Measure 3.2aa:

Recruit Additional Examiner, Economist, Accountant, and Other
Professional Staff

Annual Performance Goal 3.2b:

Maintain Appropriate Contingency Planning and Business
Continuity Plan

Annual Performance Measure 3.2bb:

Conduct Annual Review and Update of Finance Board Business
Continuity Plan

Fiscal Year 2004 Performance Summary

In fiscal year 2004, the Finance Board pursued its annual performance goals through a number of new and continuing initiatives detailed in the 2004 Annual Performance Plan. Several of these follow below:

- Continuing to develop and maintain a risk-based system of safety and soundness supervision that focuses the agency's supervisory resources upon the specific credit, market, and operational risks presented by the business and operations of each FHLBank;
- Continuing to enhance the agency's safety and soundness supervisory capabilities, including developing a skilled examination force, strengthening its off-site monitoring and risk-modeling programs, and augmenting its accounting, economics, and mortgage analysis staff;
- Improving financial reporting and disclosure by the FHLBanks;
- Continuing to assess the quality of corporate governance practices by the FHLBanks and means for their improvement;
- Continuing to enhance the agency's supervisory capabilities with respect to the housing finance and community investment mission of the FHLBanks;
- Exploring means to permit the affordable housing programs of the FHLBanks to be more responsive to diverse housing needs throughout the country;
- Improving supervisory guidance provided by the agency to its examination staff and the FHLBanks; and
- Reengineering the agency's information systems and technology capabilities to improve support for its operations.

The Finance Board has final fiscal year 2004 performance data for all nineteen of its annual performance measures.⁴ Taking account of all annual performance measures, the Finance Board met all sixteen of its annual performance goals for fiscal year 2004.⁵

⁴ The Finance Board conducts its annual cycles of safety and soundness and housing mission on-site examinations on a calendar year rather than fiscal year basis. Therefore, for purposes of this report, recorded fiscal year 2004 performance of on-site examinations reflects examinations conducted during the first three calendar quarters of this year. The agency's progress in completing its calendar year 2004 examinations cycle at September 30 was within the expectations of agency management. The Finance Board expects that it will complete its calendar year 2004 examination cycle by calendar year-end. Likewise, the Finance Board's review of community support statements of FHLBank members is conducted on a biennial calendar year cycle. Therefore, for the purposes of this report, recorded fiscal year 2004 performance reflects reviews completed during the first three calendar quarters of 2004. The agency's progress in reviewing the community support statements of FHLBank members at September 30 was within the expectations of agency management. The Finance Board expects that it will complete the calendar year 2004 portion of the current biennial review cycle by calendar year-end 2004.

⁵ *Id.*

Detailed information regarding the agency's fiscal year 2004 performance is set forth under 2004 Performance Results, below.

The Finance Board tracks its progress in achieving its annual performance goals through periodic management reporting mechanisms of various types. The agency believes the information produced by these mechanisms to be accurate.

2004 Performance Results

The success of the Finance Board in achieving its annual performance goals in fiscal year 2004 is set forth below, together with comparative annual performance data for fiscal years 2003, 2002, 2001, and 2000. Where no similar annual performance goal existed in a fiscal year, an annual performance goal is designated "New Performance Goal."

STRATEGIC GOAL 1:

The Federal Housing Finance Board's Program of Bank Supervision Fosters Safe and Sound Operations at Each of the Federal Home Loan Banks

Strategic Objective 1.1:

The Federal Home Loan Banks Operate Safely and Soundly

Annual Performance Goal 1.1a:

Maintain Effective Risk-Based Supervisory Program, Including the:
Conduct of Annual Safety and Soundness Examinations of the Twelve Federal Home Loan Banks; Provision of Enhanced Examiner Guidance and Training; and Conduct of Off-Site Monitoring and Analysis of Their Condition, Annual Testing of Their Interest Rate Risk Sensitivity, and Periodic Testing of Their Market Risk Models

Annual Performance Measure 1.1aa:

Complete Annual Safety and Soundness Examinations of the Twelve Federal Home Loan Banks; Provide Enhanced Examiner Guidance and Training; and Conduct Off-Site Monitoring and Analysis of Their Condition, Annual Testing of Their Interest Rate Risk Sensitivity, and Periodic Testing of Their Market Risk Models

Under Section 2A(a)(3)(A) of the FHLBank Act, the Finance Board is charged with ensuring that "the FHLBanks operate in a financially safe and sound manner." The cornerstone of the Finance Board's safety and soundness supervisory program is a system of periodic on-site and off-site monitoring of the risk profile, condition, and performance of each FHLBank. The on-site monitoring of each FHLBank is carried out through a safety and soundness examination that assesses the FHLBank's ability to manage credit, market, and operational risks arising from its business and operations, as well as the institution's financial condition and performance, capital adequacy, corporate governance, and compliance with laws, regulations, internal policies of the FHLBank, and policies of the Finance Board. Significant staff resources and timely examiner

guidance and training permit examination personnel to keep pace with the increasing complexity of the business of the FHLBanks. Off-site monitoring of the risk levels, condition, and performance of each FHLBank is also conducted throughout the year in conjunction with the examination function.

Fiscal Year 2004 Performance: Achieved. The Finance Board conducted on-site safety and soundness examinations of nine FHLBanks in fiscal year 2004; examinations of the remaining three FHLBanks will be completed by calendar year-end 2004.

To assist its examiners in conducting risk-focused examinations of the FHLBanks, the Finance Board continued to review and revise its examination manual in fiscal year 2004. As revised, the examination manual will provide a foundation for the review and assessment of the adequacy of risk controls maintained by the FHLBanks, as well as to provide more detailed guidance to examiners generally. The agency also commenced development of a FHLBank-wide examination rating framework pursuant to which each FHLBank will, at the conclusion of its annual on-site safety and soundness examination, be assigned a composite rating and component ratings based upon the level of credit, market, and operational risks undertaken by each FHLBank, the adequacy of its risk management practices, and other factors. The Finance Board also began the distribution of Examiner Guidance Bulletins to provide agency examiners with timely guidance as to emerging risks and other issues relevant to the examination and supervision of the FHLBanks; two such bulletins were issued in fiscal year 2004.

During fiscal year 2004, the Finance Board continued to provide market risk measurement and modeling assessments in connection with its on-site annual safety and soundness examinations of the FHLBanks. The agency also commenced the development of a standardized market risk collection system and entered into an agreement with a vendor to develop and implement an enterprise-wide risk management system.

In fiscal year 2004, the Finance Board conducted ongoing off-site monitoring of the condition and performance of, and regulatory compliance by, the FHLBanks in the context of the financial, credit, and mortgage markets in which they operate. The agency significantly strengthened its monitoring and analytical capabilities through the retention of a group of financial analysts for its FHLBank "bank analyst" program. The agency continued to enhance its data collection and monitoring capabilities, including commencing development of an enterprise data repository.

Summary of Fiscal Year 2003, 2002, 2001, and 2000 Performance

Fiscal Year 2003 Performance: Completed examinations of twelve FHLBanks during calendar year. Commenced revision of examination manual and provided examiner guidance and training opportunities. Provided market risk measurement and support in connection with examinations and reviewed market risk models of FHLBanks seeking to implement their capital structure plans. Performed monthly monitoring of FHLBank condition and performance and regulatory compliance as well as market developments, and enhanced agency data collection and monitoring capabilities.

Fiscal Year 2002 Performance: Completed examinations of twelve FHLBanks during calendar year. Provided examiner guidance and training opportunities. Provided market

risk measurement and support in connection with examinations and reviewed market risk models of FHLBanks seeking to implement their capital structure plans. Performed monthly monitoring of FHLBank condition and performance and regulatory compliance as well as market developments, and enhanced agency data collection and monitoring capabilities.

Fiscal Year 2001 Performance: Completed examinations of twelve FHLBanks during calendar year. Provided examiner guidance and training opportunities. Continued to revise and update examination manual. Provided market risk measurement and support in connection with examinations. Performed monthly monitoring of FHLBank condition and performance and regulatory compliance as well as market developments.

Fiscal Year 2000 Performance: Completed examinations of twelve FHLBanks during calendar year. Provided examiner guidance and training opportunities. Revised and updated examination manual. Provided market risk measurement and support in connection with examinations. Performed monthly monitoring of FHLBank condition and performance and regulatory compliance as well as market developments.

Annual Performance Goal 1.1b:

Apply Statutory, Regulatory, and Other Appropriate Remedies in Response to Identified Supervisory Concerns

Annual Performance Measure 1.1bb:

Assess Effectiveness of Required Corrective Actions at On-Site Safety and Soundness Examinations and at Follow-Up Reviews Conducted Quarterly or at More Frequent Intervals

Supervisory concerns regarding an FHLBank identified during an annual on-site safety and soundness examination are generally concerned through discussions between Finance Board staff and the management and board of directors of the FHLBank. When, during the course of an examination of an FHLBank, agency staff identifies a significant supervisory or compliance issue posing risk to the FHLBank, it will require the FHLBank to develop a corrective action plan to correct the violation or weakness within an appropriate timeframe. Thereafter, agency staff will monitor the FHLBank's progress in implementing the plan through follow-up discussions conducted on a quarterly or more frequent basis and subsequent annual on-site examinations.

Where warranted to ensure committed remedial action from the FHLBank, the Finance Board will invoke its informal and formal enforcement powers conferred in Sections 2B(a)(2) and 2B(a)(5) of the FHLBank Act, including supervisory resolutions and agreements, cease and desist orders, temporary cease and desist orders, removal orders, and civil money penalty assessments. If such remedies are applied, agency staff will gauge their effectiveness through follow-up discussions conducted with FHLBank management on a quarterly or more frequent basis and subsequent on-site examinations of the FHLBank.

Fiscal Year 2004 Performance: **Achieved.** During on-site safety and soundness examinations of and periodic follow-up discussions held with FHLBanks in fiscal year 2004, Finance Board staff reviewed the effectiveness of any corrective actions it required

to be undertaken by the FHLBanks. Where warranted, the FHLBanks were required to undertake further corrective action.

Summary of Fiscal Year 2003, 2002, 2001, and 2000 Performance

Fiscal Year 2003 Performance: Assessed effectiveness of required corrective actions during examinations and periodic follow-up discussions.

Fiscal Year 2002 Performance: Assessed effectiveness of required corrective actions during examinations and periodic follow-up discussions.

Fiscal Year 2001 Performance: Assessed effectiveness of required corrective actions during examinations and periodic follow-up discussions.

Fiscal Year 2000 Performance: Assessed effectiveness of required corrective actions during examinations and periodic follow-up discussions.

Strategic Objective 1.2: The Federal Home Loan Banks Meet or Exceed Their Minimum Capital Requirements

Annual Performance Goal 1.2a:

Each Federal Home Loan Bank Meets or Exceeds Its Applicable Minimum Capital Requirement on a Continuous Basis

Annual Performance Measure 1.2aa:

Each Federal Home Loan Bank Satisfies Its Applicable Capital Requirements and Prudently Manages Capital and Earnings

Section 6 of the FHLBank Act mandates that the Finance Board adopt regulations prescribing total capital and risk-based capital requirements that incorporate minimum standards enumerated in the statute. It also requires that the board of directors of each FHLBank submit for agency approval a plan establishing and implementing a capital structure for the FHLBank that, among other things, satisfies such minimum capital standards and establishes a level of investment by members in FHLBank stock that will be sufficient to ensure that the FHLBank remains in compliance with such standards.

The Finance Board monitors compliance with applicable capital requirements and evaluates capital management as part of its on-site examination of each FHLBank each year. Between annual on-site examinations, capital, including retained earnings, is monitored on a monthly basis using financial information collected from the FHLBanks.

Fiscal Year 2004 Performance: Achieved. The Finance Board conducted on-site reviews of capital of nine FHLBanks in fiscal year 2004; the agency will complete on-site reviews of capital of the remaining three FHLBanks by calendar year-end 2004. The agency also conducted off-site monitoring of capital of all twelve FHLBanks during fiscal year 2004.

Summary of Fiscal Year 2003, 2002, 2001, and 2000 Performance

Fiscal Year 2003 Performance: Assessed compliance with applicable capital requirements as well as management of capital, during annual examinations and off-site on a monthly basis.

Fiscal Year 2002 Performance: Assessed compliance with applicable capital requirements during annual examinations and off-site on a monthly basis.

Fiscal Year 2001 Performance: Assessed compliance with capital requirements during annual examinations and off-site on a monthly basis.

Fiscal Year 2000 Performance: Assessed compliance with capital requirements during annual examinations and off-site on a monthly basis.

Annual Performance Goal 1.2b:

Each Federal Home Loan Bank Implements or Makes Progress in Implementing its Capital Structure Plan

Annual Performance Measure 1.2bb:

Conduct Review of Proposed Federal Home Loan Bank Market Risk or Cash-Flow Models and Risk Assessment Procedures and Controls, and Proposed Federal Home Loan Bank Capital Structure Plan Amendments

The risk-based capital requirements mandated by Section 6 of the FHLBank Act and implemented in Part 932 of the Finance Board's regulations impose capital charges upon each FHLBank on the basis of the credit, market, and operations risks undertaken by that institution. For this reason, before an FHLBank's capital structure plan can be implemented, the Finance Board must approve the internal market risk model or internal cash-flow model used to calculate the market risk component of the FHLBank's risk-based capital requirement as well as the risk assessment procedures and controls to be used to manage its credit, market, and operations risk. The Finance Board must also approve any changes proposed by an FHLBank to an internal risk market model or internal cash-flow model that has already received agency approval. Where an FHLBank seeks to amend its capital structure plan, agency approval is required under Section 6 of the FHLBank Act.

Fiscal Year 2004 Performance: Achieved. Between fiscal years 2002 and 2004, the Finance Board reviewed and approved the market risk models or cash-flow models and risk assessment and control procedures of the nine FHLBanks that had implemented their capital structure plans and of one other FHLBank that had not yet done so. In fiscal year 2004, the Finance Board assessed the adequacy of the market risk or cash-flow models and risk assessment and control procedures of eight of these ten FHLBanks as part of its annual on-site safety and soundness examinations and will review the adequacy of the market risk models and risk assessment and control procedures of the remaining two FHLBanks by calendar year-end 2004. The agency also reviewed proposed changes by such FHLBanks to previously-approved internal market risk models or internal cash-flow models. For one of the two remaining FHLBanks that have not implemented their capital structure plans and whose market risk models or cash-flow models and risk assessment

and control procedures have not yet been approved, the Finance Board assessed the FHLBank's progress with respect to its risk assessment and control procedures, as well as its risk modeling. The agency will conduct the same assessments with respect to the second such FHLBank by calendar year-end 2004. The agency also considered four requests in fiscal year 2004 under Section 6 of the FHLBank Act by FHLBanks for approval of amendments to their capital structure plans.

Summary of Fiscal Year 2003, 2002, 2001, and 2000 Performance

Fiscal Year 2003 Performance: Conducted reviews of proposed market risk or cash-flow models, risk assessment procedures and controls, and capital structure plan amendments submitted by FHLBanks.

Fiscal Year 2002 Performance: Conducted reviews of proposed market risk or cash-flow models, risk assessment procedures and controls, and capital structure plan amendments submitted by FHLBanks.

Fiscal Year 2001 Performance: New performance goal beginning in 2002

Fiscal Year 2000 Performance: New performance goal beginning in 2002.

Strategic Objective 1.3: The Federal Home Loan Banks Raise Funds in the Capital Markets Efficiently and Are Role Models for Corporate Transparency and Accountability

Annual Performance Goal 1.3a:

Conduct Assessment of System Cost of Funds and Ratings of Federal Home Loan Bank System Consolidated Obligations and Individual Federal Home Loan Banks by Nationally Recognized Statistical Rating Organizations

Annual Performance Measure 1.3aa:

Conduct Semi-Annual Assessment of Federal Home Loan Bank System Cost of Funds

The FHLBanks raise funds in the capital markets through the issuance of consolidated obligations on which they are jointly and severally liable. The government-sponsored enterprises enables them to raise funds at rates slightly above those of obligations of comparable type and similar maturity issued by the Department of the Treasury. To measure the efficiency of the FHLBanks in raising funds, the agency conducts a semi-annual review of the FHLBanks' funding costs relative to those of the Department of the Treasury as well as with those of other government-sponsored enterprises engaged in housing-related activities. Thus, it compares the spread between FHLBank consolidated obligations with those of debt instruments of comparable type and similar maturity issued by the Department of the Treasury. It also compares the spread between FHLBank debt obligations and those of comparable type and similar maturity issued by Fannie Mae and Freddie Mac.

Fiscal Year 2004 Performance: Achieved. The Finance Board conducted both cost of funds comparisons in 2004.

Summary of Fiscal Year 2003, 2002, 2001, and 2000 Performance

Fiscal Year 2003 Performance: New performance goal beginning in fiscal year 2004.

Fiscal Year 2002 Performance: New performance goal beginning in fiscal year 2004.

Fiscal Year 2001 Performance: New performance goal beginning in fiscal year 2004.

Fiscal Year 2000 Performance: New performance goal beginning in fiscal year 2004.

Annual Performance Measure 1.3aaa:

Monitor Compliance by Federal Home Loan Banks with Federal Housing Finance Board Requirement of Minimum Ratings by Nationally Recognized Statistical Ratings Organizations

To ensure that the FHLBanks are able to issue consolidated obligations in the capital markets at the lowest possible cost, the Finance Board, in Section 966.3(b) and (c) of its regulations, requires the maintenance of the highest credit rating available from any NRSRO on their consolidated obligations as well as at least the second highest individual issuer credit rating on each FHLBank as an individual issuer where such rating is a meaningful measure of the FHLBank's financial strength and is updated by the NRSRO at intervals prescribed in the regulation. Standard & Poor's Ratings Group (Standard & Poor's) and Moody's Investors Service, Inc. (Moody's) have rated the long-term consolidated obligations of the FHLBanks AAA and Aaa, respectively, and the short-term consolidated ratings of the FHLBanks, P-1 and A-1+, respectively, their highest ratings; each of the FHLBanks has received an individual issuer credit rating of at least AA or Aa, respectively, the second highest such rating awarded by Standard & Poor's and Moody's.

Fiscal Year 2004 Performance: Achieved. In fiscal year 2004, the Finance Board monitored the application by NRSROs of the highest credit rating to System consolidated obligations and of at least their second highest individual issuer credit rating to the FHLBanks individually, as appropriate, through participation in ratings conference calls and other discussions with the NSRSOs as well as through other means.

Summary of Fiscal Year 2003, 2002, 2001, and 2000 Performance

Fiscal Year 2003 Performance: Conducted periodic monitoring of ratings.

Fiscal Year 2002 Performance: Conducted periodic monitoring of ratings.

Fiscal Year 2001 Performance: Conducted periodic monitoring of ratings.

Fiscal Year 2000 Performance: Conducted periodic monitoring of ratings.

Annual Performance Goal 1.3b:

Assess Compliance of Federal Home Loan Bank and Federal Home Loan Bank System Financial Reporting and Federal Home Loan Bank Consolidated Obligation Sales with the Disclosure and Customer Suitability Requirements of the Federal Housing Finance Board's Regulations

Annual Performance Measure 1.3bb:

Conduct Review of Annual and Quarterly Federal Home Loan Bank System Combined Financial Reports and Financial Reports Issued by Individual Federal Home Loan Banks for Compliance with the Disclosure Requirements of Federal Housing Finance Board Regulations

Part 985 of the Finance Board's regulations requires the preparation and issuance of annual and quarterly financial reports Bank System Combined Reports by OF. Accordingly, each year OF prepares and issues an annual and three quarterly Bank System Combined Reports derived from financial information submitted to it by the FHLBanks. In addition to the Bank System Combined Reports prepared and issued by OF, annual and quarterly financial reports are prepared and issued by each of the FHLBanks. The Finance Board conducts a review of all Bank System Combined Reports prepared and issued by OF as well as of all annual and quarterly reports prepared and issued by the individual FHLBanks, for compliance with the disclosure requirements of Part 985.

Fiscal Year 2004 Performance: Achieved. The Finance Board reviewed the annual and quarterly Bank System Combined Reports issued by OF and reports issued by the individual FHLBanks in fiscal year 2004.

Summary of Fiscal Year 2003, 2002, 2001, and 2000 Performance

Fiscal Year 2003 Performance: All System- and FHLBank-issued financial reports reviewed.

Fiscal Year 2002 Performance: All System- and FHLBank-issued financial reports reviewed.

Fiscal Year 2001 Performance: All System- and FHLBank-issued financial reports reviewed.

Fiscal Year 2000 Performance: All System- and FHLBank-issued financial reports reviewed.

Annual Performance Measure 1.3bbb:

Conduct Annual On-Site Examination of the Office of Finance

The Finance Board conducts an annual on-site examination of OF to assess the latter's ability to carry out its prescribed functions under Part 985 of the agency's regulations. OF's operations and corporate governance practices are also reviewed.

Fiscal Year 2004 Performance: Achieved. The Finance Board conducted its most recent on-site examination of OF in December 2003. The agency will conduct its calendar year 2004 examination of OF in December.

Summary of Fiscal Year 2003, 2002, 2001, and 2000 Performance

Fiscal Year 2003 Performance: Examination completed.

Fiscal Year 2002 Performance: Examination completed.

Fiscal Year 2001 Performance: Examination completed.

Fiscal Year 2000 Performance: Examination completed.

STRATEGIC GOAL 2:

The Federal Housing Finance Board Ensures that the Federal Home Loan Banks Serve the Nation's Housing Finance and Community Investment Needs

**Strategic Objective 2.1:
The Federal Home Loan Banks Facilitate the Housing
Finance Activities of Their Members**

Annual Performance Goal 2.1a:

Conduct Review of Advance Portfolio of Each Federal Home Loan Bank as Part of Annual On-Site Safety and Soundness Examination

Annual Performance Measure 2.1aa:

Complete Review of Advance Portfolio of Each Federal Home Loan Bank as Part of Annual On-Site Safety and Soundness Examination

The authority for and general conditions attending the extension of advances by the FHLBanks to their member institutions and qualified housing associates are contained in Sections 7(j), 9, 10, and 10b of the FHLBank Act and in Part 950 of the Finance Board's regulations. As part of the annual on-site safety and soundness examination conducted of each FHLBank, the Finance Board evaluates the institution's advance and collateral policies and practices to ensure consistency with the FHLBank Act and Part 950 of its regulations as well as for other purposes. Between annual on-site examinations, the Finance Board conducts off-site monitoring of FHLBank advance activities and collateral practices. The agency also reviews notifications submitted by FHLBanks proposing to conduct advance activities or accept certain advance collateral entailing new risks for that institution.

Fiscal Year 2004 Performance: Achieved. The Finance Board examined the advance portfolios of nine FHLBanks as part of its on-site examinations in fiscal year 2004 and will examine the advance portfolios of the remaining three FHLBanks by calendar year-

end 2004. The agency conducted off-site monitoring of the size and composition of the advance portfolio of each FHLBank during fiscal year 2004. In addition, the Finance Board approved two new business activity notices in fiscal year 2004 relating to the acceptance by an FHLBank of collateral entailing new risks.

Summary of Fiscal Year 2003, 2002, 2001, and 2000 Performance

Fiscal Year 2003 Performance: Advance portfolios reviewed as part of annual examinations.

Fiscal Year 2002 Performance: Advance portfolios reviewed as part of annual examinations.

Fiscal Year 2001 Performance: Advance portfolios reviewed as part of annual examinations.

Fiscal Year 2000 Performance: Advance portfolios reviewed as part of annual examinations.

Annual Performance Goal 2.1b:

Conduct Review of Acquired Member Asset Portfolio of Each Federal Home Loan Bank as Part of Annual On-Site Safety and Soundness Examination

Annual Performance Measure 2.1bb:

Complete Review of Acquired Member Asset Portfolio of Each Federal Home Loan Bank as Part of Annual On-Site Safety and Soundness Examination

Pursuant to Part 955 of the Finance Board's regulations, FHLBanks are authorized to hold real estate assets—AMA—acquired from or through FHLBank members or housing associates. AMA assets are acquired by FHLBanks pursuant to FHLBank-sponsored programs under which the FHLBanks fund or acquire mortgage assets from a member institution or housing associate through a risk structure that allocates market risk to the FHLBank and credit risk to both the member or housing associate and the FHLBank on a shared basis. All FHLBanks participate in such programs.

As part of the annual on-site safety and soundness examination conducted at each FHLBank, the Finance Board evaluates the compliance of each FHLBank's AMA program and activities with the requirements of Part 955 of its regulations as well as for other purposes. In addition to annual on-site examinations, the Finance Board analyzes certain information regarding FHLBank AMA program activities collected through off-site means. The agency also reviews notifications submitted by any FHLBank proposing to conduct an AMA activity or acquire an AMA program asset entailing new risks for that institution.

Fiscal Year 2004 Performance: Achieved. The agency examined the AMA programs and program loans of nine FHLBanks as part of its annual on-site examinations in fiscal year 2004 and will examine the AMA programs and program loans of the remaining three

FHLBanks by calendar year-end 2004. The agency conducted an analysis of certain information received from the FHLBanks as to the geographic distribution and performance status of AMA program loans over time as well as to demographic characteristics AMA program loan borrowers, once in fiscal year 2004.

Summary of Fiscal Year 2003, 2002, 2001, and 2000 Performance

Fiscal Year 2003 Performance: AMA portfolios reviewed as part of annual examinations.

Fiscal Year 2002 Performance: AMA portfolios reviewed as part of annual examinations.

Fiscal Year 2001 Performance: AMA portfolios reviewed as part of annual and pre-implementation examinations.

Fiscal Year 2000 Performance: AMA portfolios reviewed in special examination.

Strategic Objective 2.2: The Federal Home Loan Banks Support Affordable Housing and Promote Community Development

Annual Performance Goal 2.2a:

Conduct Annual On-Site Examination of the Affordable Housing Program, Community Investment Program and, as Applicable, Other Community Investment Cash Advance Programs, of Each Federal Home Loan Bank

Annual Performance Measure 2.2aa:

Complete Annual On-Site Examination of the Affordable Housing Program, Community Investment Program and, as Applicable, Other Community Investment Cash Advance Programs, of Each Federal Home Loan Bank

Section 10 of the FHLBank Act establishes affordable housing and community investment requirements and opportunities for the FHLBanks. It is a strategic objective of the Finance Board to support the affordable housing and community investment objectives of the FHLBank Act by maintaining an effective program of annual on-site examination for the AHP, CIP, and as applicable, other CICA programs, of each FHLBank.

Fiscal Year 2004 Performance: Achieved. The Finance Board completed full-scale or limited scope on-site examinations of the AHP, CIP, and, as applicable, other CICA programs, of seven of the FHLBanks in fiscal year 2004. The agency will conduct limited scope examinations of the AHP, CIP, and, as applicable, other CICA programs, of the remaining five FHLBanks by calendar year-end 2004.

Summary of Fiscal Year 2003, 2002, 2001, and 2000 Performance

Fiscal Year 2003 Performance: Completed examinations of twelve FHLBanks during calendar year.

Fiscal Year 2002 Performance: Completed examinations of twelve FHLBanks during calendar year.

Fiscal Year 2001 Performance: Completed examinations of eleven FHLBanks during calendar year.

Fiscal Year 2000 Performance: New performance goal beginning in fiscal year 2001.

Annual Performance Goal 2.2b:

Apply Statutory, Regulatory, and Other Appropriate Remedies in Response to Identified Concerns

Annual Performance Measure 2.2bb:

Assess Effectiveness of Required Corrective Actions at On-Site Examinations or at Periodic Follow-Up Reviews

Concerns regarding an FHLBank identified during an examination of the institution's AHP, CIP, and, as applicable, other CICA programs, are generally resolved through discussions between Finance Board staff and the management and board of directors of the FHLBank. Where warranted, the FHLBank will be required to take additional remedial action depending upon the type of program involved and the nature of its concern. If such remedies are applied, agency staff will assess their effectiveness through follow-up discussions conducted with FHLBank management on a periodic basis and subsequent on-site examinations of the FHLBank.

Fiscal Year 2004 Performance: Achieved. During on-site examinations of the AHP, CIP, and, as applicable, other CICA programs, of the FHLBanks in fiscal year 2004 and periodic follow-up discussions with these institutions during that year, Finance Board staff assessed the effectiveness of corrective actions it required to be undertaken by the FHLBanks. Where warranted, the FHLBanks were required to undertake further corrective action.

Summary of Fiscal Year 2003, 2002, 2001, and 2000 Performance

Fiscal Year 2003 Performance: Assessed effectiveness of required corrective actions during examinations and periodic follow-up discussions.

Fiscal Year 2002 Performance: Assessed effectiveness of required corrective actions during examinations and periodic follow-up discussions.

Fiscal Year 2001 Performance: Assessed effectiveness of required corrective actions during examinations and periodic follow-up discussions.

Fiscal Year 2000 Performance: New performance goal beginning in fiscal year 2001.

Annual Performance Goal 2.2c:

Conduct Annual Review of Federal Home Loan Bank Community Lending Plans and Biennial Review of Federal Home Loan Bank Member Community Support Statements

Annual Performance Measure 2.2cc:

Complete Annual Review of Federal Home Loan Bank Community Lending Plans and Biennial Review of Federal Home Loan Bank Member Community Support Statements

Pursuant to Part 944 and Section 952.4 of the Finance Board's regulations, each FHLBank is required to seek Finance Board review of and adopt an annual community lending plan that requires the institution to: (i) conduct market research in its district; (ii) describe the manner in which it will address identified credit needs and market opportunities in its district for targeted community lending; (iii) consult with its advisory council and its members, housing associates, and public and private economic development organizations in its district in developing and implementing the plan; and (iv) establish quantitative community lending performance goals for that year. Part 944 also mandates the solicitation and review by the Finance Board of community support statements of an FHLBank member approximately once every two years through a notification and review procedure prescribed in that part. Where a member has failed to comply with the requirements of Part 944, the Finance Board will restrict a member's access to long-term advances.

Fiscal Year 2004 Performance: Achieved. In fiscal year 2004, the Finance Board completed the review of community lending plans of the twelve FHLBanks. The agency also completed its review of the community support statements of 1,923 FHLBank members in fiscal year 2004; the agency anticipates that it will complete its review of the community support statements of an additional 674 FHLBank members by calendar year-end 2004. The agency restricted FHLBank member access to long-term advances on seven occasions in fiscal year 2004 for failure to adhere to the requirements of Part 944.

Summary of Fiscal Year 2003, 2002, 2001, and 2000 Performance

Fiscal Year 2003 Performance: Completed review of community lending plans of twelve FHLBanks; completed review of community support statements of 4,497 FHLBank members by calendar year-end.

Fiscal Year 2002 Performance: Completed review of community lending plans of twelve FHLBanks; completed review of community support statements of 2,913 FHLBanks members by calendar year-end.

Fiscal Year 2001 Performance: Completed review of community lending plans of twelve FHLBanks; completed review of community support statements of 3,225 FHLBanks by calendar year-end.

Fiscal Year 2000 Performance: Completed review of community lending plans of twelve FHLBanks; completed review of community support statements of 2,515 FHLBanks by calendar year-end.

Annual Performance Goal 2.2d:

Carry Out Statutory Duty to Appoint Public Interest Directors, Including Community Interest Directors, to the Board of Directors of Each Federal Home Loan Bank

Annual Performance Measure 2.2dd:

Appoint Public Interest Directors, Including Community Interest Directors, to the Board of Directors of Each Federal Home Loan Bank Each Year

Section 7(a) of the FHLBank Act specifies that the board of directors of each FHLBank be comprised, generally, of eight directors elected by the institutions members and six directors appointed by the Finance Board. At least two of the directors of each FHLBank appointed by the Finance Board are required to be chosen from organizations with more than a two-year history of representing consumer or community interests on banking services, credit needs, housing, or financial consumer protections. The agency appoints or reappoints qualified public interest directors, including community interest directors, each calendar year to fill vacancies occurring on the board of directors of each FHLBank.

Fiscal Year 2004 Performance: Achieved. In January 2004, the Finance Board appointed or reappointed, as the case may be, public interest directors, including community interest directors, for vacancies occurring at the end of 2003. The agency is soliciting potential candidate nominations for vacancies occurring at the end of 2004.

Summary of Fiscal Year 2003, 2002, 2001, and 2000 Performance

Fiscal Year 2003 Performance: Appointments and reappointments made for calendar year 2003.

Fiscal Year 2002 Performance: Appointments and reappointments made for calendar year 2002.

Fiscal Year 2001 Performance: Appointments and reappointments made for calendar year 2001.

Fiscal Year 2000 Performance: Appointments and reappointments made for calendar year 2000.

STRATEGIC GOAL 3:

The Federal Housing Finance Board's Supervisory, Managerial, and Legal Resources Support Effective, Efficient, and Responsive Bank Supervision and Regulation and Housing Mission Oversight

Strategic Objective 3.1:

The Federal Housing Finance Board Takes Appropriate and Timely Regulatory and Advisory Actions

Annual Performance Goal 3.1a:

Review, Revise, and Supplement Federal Housing Finance Board Regulations to Ensure Relevance and Transparency and Issue Results-Oriented Supervisory Guidance

Annual Performance Measure 3.1aa:

Conduct Review of Federal Housing Finance Board Regulations and Revise and Supplement These Where Appropriate

Fiscal Year 2004 Performance: Achieved. In fiscal year 2004, the Finance Board continued to review its regulations to ensure the consistency of these with the agency's risk-focused regulatory and supervisory program and priorities. The agency also continued to identify and adopt, both in its review and revision of its regulations and otherwise, effective practices in regulatory supervision, and work with other financial institution regulators to identify such practices. Significant rule-making initiatives undertaken by the agency in fiscal year 2004 are set forth below.

(i) Adoption of Part 998 of the Finance Board's Regulations—Registration of a Class of Securities of Each FHLBank under Section 12(g) of the 1934 Act.

On June 23, 2004, the Finance Board adopted Part 998 of its regulations requiring each FHLBank to register a class of its equity securities with the SEC under Section 12(g) of the 1934 Act.

(ii) Amendments to Parts 900, 932, and 955 of the Finance Board's Regulations—FHLBank AMA.

Finance Board staff continued to prepare amendments to a proposed rule that would amend Parts 900, 932, and 955 of its regulations principally to place greater responsibility with each FHLBank to manage its AMA program, subject to ongoing supervision and review by the agency. A previous version of the proposed amendments was withdrawn by the Finance Board on September 17, 2003.

(iii) Amendments to Part 951 of the Finance Board's Regulations—FHLBank AHP.

Finance Board staff continued to prepare amendments to Part 951 of its regulations to place greater responsibility with each FHLBank to manage its AHP program, subject to

ongoing supervision and review by the agency. These reflect findings made by the agency in its horizontal review of FHLBank AHP programs conducted in 2003 and 2004.

(iv) Amendments to the Finance Board's Regulations—Data Quality and Timeliness Regulation.

Finance Board staff prepared amendments to its regulations that would establish data reporting standards applicable to the FHLBanks and address enforcement authority of the agency to ensure timely, accurate, and complete submissions of data from the FHLBanks.

Summary of Fiscal Year 2003, 2002, 2001, and 2000 Performance

Fiscal Year 2003 Performance: Review of Finance Board regulations continued; amendments to Parts 900, 932, and 955 (FHLBank AMA) published for public comment and withdrawn; proposed Part 998 (registration of FHLBank equity securities with SEC) published for public comment; interim amendments to Parts 910 and 913 (Privacy Act and Freedom of Information Act) adopted; amendments to Part 906 (conduct of Monthly Survey of Rates and Terms of Conventional Mortgages) adopted; amendments to Parts 900 and 905 (Finance Board organization and functions) adopted; and proposed amendments to Part 915 (FHLBank board of directors composition) published for public comment.

Fiscal Year 2002 Performance: Review of Finance Board regulations commenced; amendments to Parts 907 and 908 (Finance Board rules of practice and procedure) adopted; amendments to Section 932.9 (FHLBank unsecured credit limits) adopted; technical amendments to Parts 900, 931, 932, and 933 (FHLBank capital standards and capital structure plans) adopted; amendments to Part 918 (FHLBank board of directors meetings) adopted; amendments to Part 951 (FHLBank AHP) adopted; amendments to Parts 900 and 952 (FHLBank CICA) adopted; technical amendments to various parts adopted; amendments to Part 985 (OF board of directors meetings) adopted; and amendments to Part 966 (System consolidated obligations) adopted.

Fiscal Year 2001 Performance: Proposed amendments to Parts 907 and 908 (Finance Board rules of practice and procedure) published for public comment; amendments to Parts 900, 930, 931, 932, and 933 (FHLBank capital standards and capital structure plans) adopted; proposed amendments to Section 932.9 (FHLBank unsecured credit limits) published for public comment; proposed technical amendments to Parts 900, 931, 932, and 933 (FHLBank capital standards and capital structure plans) published for public comment; interim amendments to Part 918 (FHLBank board of directors meetings) adopted; proposed amendments to Part 951 (FHLBank AHP) published for public comment; and proposed amendments to Parts 900 and 952 (FHLBank CICA) published for public comment.

Fiscal Year 2000 Performance: Amendments to Part 910 (System consolidated obligations) adopted; amendments to Parts 900, 905, 965, 966, 969, 985, and 989 (System consolidated obligations) adopted; amendments to Part 900 and 940 (FHLBank financial management and mission achievement) withdrawn; interim amendments to Part 925 (FHLBank membership requirements) adopted; interim amendments to Part 950 (FHLBank advance collateral) adopted; amendments to Parts 900, 940, 950, 955, 956, and 966 (FHLBank AMA, core mission activities, investments, and advances) adopted;

proposed amendments to Parts 900, 930, 931, 932, and 933 (FHLBank capital standards and capital structure plans) published for public comment; technical amendments to various parts adopted; amendments to Part 980 (FHLBank new business activities) adopted; interim amendments to Parts 932, 934, and 935 (devolution of FHLBank corporate governance responsibilities) adopted; and amendments to Parts 900, 917, and 940 (FHLBank board of directors and senior management powers and responsibilities) adopted.

Annual Performance Measure 3.1aaa:
Issue Results-Oriented Supervisory Guidance

Fiscal Year 2004 Performance: Achieved. In fiscal year 2004, the Finance Board continued to develop and issue anticipatory, results-oriented supervisory guidance to the FHLBanks. Timely guidance was provided in response to the evolving activities and operations of the FHLBanks, developments in the financial markets, and recently identified supervisory issues and best practices. In this connection, the agency continued to identify and incorporate effective practices in regulatory supervision into its supervisory guidance and worked with other financial institution regulators to identify such practices. Supervisory guidance and advisory initiatives undertaken by the Finance Board in fiscal year 2004 are described below.

(i) Risk Assessment and Management.

The Finance Board developed and issued advisory bulletins addressing the following issues: the measurement and modeling of market risk exposure and the establishment of market risk limits; the establishment of exposure limits to supplemental mortgage insurance providers that provide credit enhancement to AMA portfolios; the evaluation of the adequacy of internal controls maintained by outside service organizations; the rating of small loan pools; and approval of changes to internal risk models.

(ii) Corporate Governance.

The Finance Board developed and issued an advisory bulletin addressing the adequacy of minutes of meetings of the boards of directors and board committees of the FHLBanks and their submission to the agency.

(iii) Financial Reporting and Disclosure.

The Finance Board developed and issued advisory bulletins addressing the preparation of periodic financial reports by the FHLBanks and their filing with OF, as well as establishing a requirement that FHLBanks report their progress in registering a class of equity securities with the SEC pursuant to Part 998 of the agency's regulations.

(iv) Examination Findings Categories.

The Finance Board developed and issued an advisory bulletin announcing and describing modifications to its categories of safety and soundness examination findings.

(v) Examination Guidance.

The Finance Board developed and issued examination guidance which was provided to the FHLBanks for use in assessing an FHLBank's capital management and retained earnings in light of fiscal year 2003 supervisory guidance addressing this subject. The agency also developed and issued examination guidance which was provided to the FHLBanks for use in assessing the adequacy of an FHLBank's policies, procedures, and practices in addressing liability exposure resulting from state predatory lending laws.

Summary of Fiscal Year 2003, 2002, 2001, and 2000 Performance

Fiscal Year 2003 Performance: Supervisory guidance issued addressing the following issues: accelerated financial reporting; business continuation contingency planning; expanded financial disclosures; capital structure plan amendments; annual risk assessments; NRSRO ratings methodologies and state predatory lending laws; internal market risk model validation; capital management and retained earnings; calculation of duration of equity and limits in low interest rate environments and related reporting requirements; Value-at-Risk modeling; revisions to safety and soundness examination findings categories; credit risk exposure to supplemental mortgage insurance providers; financial reporting and disclosure; AHP subsidy and recapture and retention agreement and reasonable collection effort requirements; qualification of certain government securities as collateral under the FHLBank Act; application of interim capital requirements; and classification of MAST Bonds.

Fiscal Year 2002 Performance: Supervisory guidance issued addressing the following issues: interest rate modeling; strategic plan reporting; disaster recovery planning; auditor independence and risk assessment; quarterly liquidity certification; unsecured credit reporting requirements; credit watch for unsecured credit; sponsor leasehold interests in AHP rental project buildings and underlying land; status of certain loans within AMA programs; use of mortgage pool insurance in credit enhancement in AMA programs; electronic distribution of combined financial reports; and obligations of state housing finance agencies and unsecured credit limitations.

Fiscal Year 2001 Performance: Supervisory guidance issued addressing the following issues: data collection and reporting requirements; securing AMA enhancements; short-term unsecured counterparty ratings and Finance Board Financial Management Policy; conflicts of interest; credit underwriting and regulatory compliance and housing associates; AMA data submissions; asset review and classification; vigilance in risk monitoring; Finance Board staffing changes; AMA programs assets held for a valid business purpose; OF audit committee and combined financial statements; elections of FHLBank directors; FHLBank membership eligibility of privately insured credit unions; Finance Board Financial Management Policy applicability to equity option transactions; short-cut method hedge accounting; valid economic hedges and securities carried at fair value; independent auditor review of quarterly financial information; mortgage loan participation interests as advance collateral; mobile home park project treatments under Part 951 of the Finance Board's regulations; Refinancing Corporation financial statement presentation; bank small business grant programs under Part 952 of the Finance Board's regulations; and acceptance of certain mutual funds and collateral.

Fiscal Year 2000 Performance: Supervisory guidance issued addressing the following issues: the use of IDC ratings in extending unsecured credit; Finance Board interest rate risk model; unmet credit need performance; putable advance disclosures; revisions to examinations findings categories; new leverage limit reporting; quarterly liquidity certification requirement; capital stock sales; targeted mortgage purchase program; AHP lease-purchase program project treatment; standby bond purchase agreements with housing finance agencies; non-mortgage investment ratio determination using an average monthly basis; multifamily mortgage loan purchase; application of five-year waiting period to institutions seeking to reapply for FHLBank membership; equity investment in Brownfields site redevelopment projects; statutory annual director compensation cap applicability in calendar year 1999; audit committee disclosures; and FHLBank director elections.

Annual Performance Goal 3.1b:

Review and Act Upon New Business Activity Notifications by Federal Home Loan Banks Promptly and Comprehensively

Annual Performance Measure 3.1bb:

Respond to New Business Activity Notifications by Federal Home Loan Banks within Sixty Days of Receipt

Pursuant to Part 980 of the Finance Board's regulations, an FHLBank intending to engage in a "new business activity" must file a prior notice of its intent to do so with the Finance Board. Part 980 provides that within sixty days after receipt of such notice, the agency may issue a response to the FHLBank setting forth its disposition of the notice.

Fiscal Year 2004 Performance: Achieved. The Finance Board processed three new business activity notifications in fiscal year 2004 pursuant to Part 980 of the agency's regulations.

Summary of Fiscal Year 2003, 2002, 2001, and 2000 Performance

Fiscal Year 2003 Performance: Five new business activity notices responded to, within sixty days of receipt.

Fiscal Year 2002 Performance: Twenty-one new business activity notices responded to, within sixty days of receipt.

Fiscal Year 2001 Performance: Twenty-six new business activity notices responded to, within sixty days of receipt.

Fiscal Year 2000 Performance: Twelve new business activity notices responded to, within sixty days of receipt, beginning from the effective date of Part 980 of the Finance Board's regulations to fiscal year-end.

Strategic Objective 3.2:
The Federal Housing Finance Board Makes Prudent Resource Management
Allocations in Order to Fulfill Its Mission Effectively and Efficiently

Annual Performance Goal 3.2a:

Recruit, Retain, and Develop High-Achieving Professional Staff

Annual Performance Measure 3.2aa:

Recruit Additional Examiner, Economist, Accountant, and Other Professional Staff

In view of the increasing size and complexity of the FHLBanks, continued successful mission fulfillment by the Finance Board requires continuing augmentation of its staff with high-achieving professionals in various disciplines and the maintenance and support of a highly qualified, skilled, and diverse workforce.

Fiscal Year 2004 Performance: Achieved. In fiscal year 2004, the Finance Board recruited forty staff members, including examiners, economists, accountants, and other professional staff.

Summary of Fiscal Year 2003, 2002, 2001, and 2000 Performance

Fiscal Year 2003 Performance: Mortgage analyst and additional examiners recruited.

Fiscal Year 2002 Performance: Additional examiners recruited.

Fiscal Year 2001 Performance: Mortgage analyst and additional examiners recruited.

Fiscal Year 2000 Performance: Mortgage analyst and additional examiners recruited.

Annual Performance Goal 3.2b:

Maintain Appropriate Contingency Planning and Business Continuity Plan

Annual Performance Measure 3.2bb:

Conduct Annual Review and Update of Finance Board Business Continuity Plan

Continuity of operations has been a major focus of the Finance Board in response to the frequency of U.S. Department of Homeland Security terror alerts at the "Orange" level in Washington, D.C. The Finance Board has taken measures to ensure that there is a continuity of operations, including preparing and implementing an interim continuity of operations plan, developing emergency response and business continuity plans, performing tests of these plans, creating an emergency site, and establishing an emergency web site and telephone number.

Fiscal Year 2004 Performance: Achieved. In fiscal year 2004, the Finance Board developed, reviewed, and updated its business continuity plan.

Summary of Fiscal Year 2003, 2002, 2001, and 2000 Performance

Fiscal Year 2003 Performance: Business continuity plan reviewed and updated.

Fiscal Year 2002 Performance: Business continuity plan reviewed and updated.

Fiscal Year 2001 Performance: New performance goal beginning in 2002.

Fiscal Year 2000 Performance: New performance goal beginning in 2002.

III. Audited Financial Statements

The Federal Housing Finance Board Financial Statements and Independent Auditor's Report are included in their entirety on the pages that follow.

**FEDERAL HOUSING FINANCE BOARD
FINANCIAL STATEMENTS
AND
INDEPENDENT AUDITOR'S REPORT**

**FOR THE YEARS ENDED
SEPTEMBER 30, 2004 AND 2003**

REPORT NO. 04-A-05-OM

**FEDERAL HOUSING FINANCE BOARD
FINANCIAL STATEMENTS
AND
INDEPENDENT AUDITOR'S REPORT
FOR THE YEARS ENDED SEPTEMBER 30, 2004 AND 2003**

TABLE OF CONTENTS

	<u>PAGE</u>
INDEPENDENT AUDITOR'S REPORT ON THE FINANCIAL STATEMENTS.....	1
BALANCE SHEETS	2
STATEMENTS OF REVENUE, EXPENSES AND CHANGES IN NET POSITION	3
STATEMENTS OF CASH FLOWS.....	4
NOTES TO FINANCIAL STATEMENTS	5
INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING	10
INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE WITH LAWS AND REGULATIONS	11



BROWN & COMPANY CPAs, PLLC
CERTIFIED PUBLIC ACCOUNTANTS AND MANAGEMENT CONSULTANTS

INDEPENDENT AUDITOR'S REPORT ON THE FINANCIAL STATEMENTS

Office of the Inspector General
Board of Directors
Federal Housing Finance Board
Washington, D.C.

We have audited the accompanying balance sheets of the Federal Housing Finance Board (the Finance Board) as of September 30, 2004 and 2003, and the related statements of revenue, expenses and changes in net position and cash flows for the years then ended. These financial statements are the responsibility of the Finance Board's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America, and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Federal Housing Finance Board as of September 30, 2004 and 2003, and the results of its operations, changes in its net position, and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report dated October 28, 2004 on our consideration of the Finance Board's internal control over financial reporting and a report dated October 28, 2004 on its compliance with laws and regulations. These reports are an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Brown & Company

Largo, Maryland
October 28, 2004

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**FEDERAL HOUSING FINANCE BOARD
BALANCE SHEETS
SEPTEMBER 30, 2004 AND 2003**

ASSETS

	<u>2004</u>	<u>2003</u>
CURRENT ASSETS		
Cash Held at U.S. Treasury	\$ 10,147,022	\$ 7,484,865
Accounts Receivable	4,633	10,765
Prepaid Expenses (Note 2)	<u>28,512</u>	<u>222,408</u>
Total Current Assets	10,180,167	7,718,038
LONG-TERM ASSETS		
Property and Equipment, net (Note 3)	<u>2,058,342</u>	<u>3,199,064</u>
Total Assets	<u>\$ 12,238,509</u>	<u>\$ 10,917,102</u>

LIABILITIES AND NET POSITION

CURRENT LIABILITIES

Accounts Payable and Accrued Expenses	\$ 1,517,648	\$ 898,446
Accrued Payroll and Related Cost	569,889	530,893
Accrued Annual Leave	1,113,014	945,361
Lease Obligations (Note 5)	27,844	21,050
Other Current Liabilities	<u>5,000</u>	<u>5,000</u>
Total Current Liabilities	3,233,395	2,400,750

LONG-TERM DEBT

Lease Obligations (Note 5)	<u>40,268</u>	<u>48,403</u>
Total Liabilities	3,273,663	2,449,153

NET POSITION (Note 6)

	<u>8,964,846</u>	<u>8,467,949</u>
Total Liabilities and Net Position	<u>\$ 12,238,509</u>	<u>\$ 10,917,102</u>

The accompanying notes are an integral part of these financial statements.

FEDERAL HOUSING FINANCE BOARD
STATEMENTS OF REVENUE, EXPENSES AND CHANGES IN NET POSITION
FOR THE YEARS ENDED SEPTEMBER 30, 2004 AND 2003

	<u>2004</u>	<u>2003</u>
REVENUE:		
FHLBank Assessments (Notes 1, 2, and 7)	\$ 25,744,343	\$ 22,455,512
Other Revenue	<u>7,627</u>	<u>758</u>
Total Revenue	<u>25,751,970</u>	<u>22,456,270</u>
EXPENSES:		
Compensation	12,921,779	11,611,433
Employee Taxes and Benefits	3,277,321	3,663,789
Rents, Communication and Utilities	2,506,723	2,282,852
Data Processing Services	137,892	124,178
Professional Services	3,884,779	2,248,808
Travel and Transportation	818,278	715,898
Training and Meetings	248,191	218,985
Supplies, Material and Postage	135,458	168,105
Printing and Reproduction	54,163	84,390
Building Services	53,748	25,641
Non-Capitalized Furniture, Fixtures and Equipment	34,933	82,697
Depreciation and Amortization	1,163,244	1,159,317
Interest	7,450	17,242
Other	<u>11,114</u>	<u>9,001</u>
Total Expenses	<u>25,255,073</u>	<u>22,412,336</u>
Revenue Over Expenses (Change in Net Position)	496,897	43,934
Net Position - October 1, 2003 and 2002	<u>8,467,949</u>	<u>8,424,015</u>
Net Position - September 30, 2004 and 2003	<u>\$ 8,964,846</u>	<u>\$ 8,467,949</u>

The accompanying notes are an integral part of these financial statements.

FEDERAL HOUSING FINANCE BOARD
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED SEPTEMBER 30, 2004 AND 2003

	<u>2004</u>	<u>2003</u>
<i>Cash Flows from Operating Activities</i>		
Cash Received from FHLBanks and Others	\$ 25,776,102	\$ 22,471,449
Cash Paid to Employees and Suppliers	(23,071,570)	(22,512,546)
Interest Paid	<u>(7,450)</u>	<u>(17,242)</u>
Net Cash Provided (Used) by Operating Activities	<u>2,697,082</u>	<u>(58,339)</u>
<i>Cash Flows from Investing Activities</i>		
Purchase of Fixed Assets	<u>(11,044)</u>	<u>(501,940)</u>
Net Cash Used by Investing Activities	<u>(11,044)</u>	<u>(501,940)</u>
<i>Cash Flows from Financing Activities</i>		
Principal Payments on Capital Lease Obligations	<u>(23,881)</u>	<u>(46,301)</u>
Net Cash Used by Financing Activities	<u>(23,881)</u>	<u>(46,301)</u>
Net Increase (Decrease) in Cash	2,662,157	(606,580)
Cash, October 1, 2003 and 2002	<u>7,484,865</u>	<u>8,091,445</u>
Cash, September 30, 2004 and 2003	<u>\$ 10,147,022</u>	<u>\$ 7,484,865</u>
<i>Reconciliation of Net Income to Net Cash Provided (Used) by Operating Activities</i>		
Net Revenue Over Expenses	\$ 496,897	\$ 43,934
Adjustments to Reconcile Net Income to Net Cash Provided (Used) by Operating Activities:		
Depreciation and Amortization	1,163,244	1,159,317
Losses on Disposition of Assets	11,062	8,162
(Increase) Decrease:		
Accounts Receivable	6,132	(2,821)
Other Assets	193,895	(44,772)
Increase (Decrease):		
Accounts Payable/Accrued Expenses	619,202	(497,030)
Accrued Payroll and Related Costs	38,996	(617,519)
Accrued Annual Leave	<u>167,654</u>	<u>(107,610)</u>
Net Cash Provided (Used) by Operating Activities	<u>\$ 2,697,082</u>	<u>\$ (58,339)</u>
<i>Schedule of Non-Cash Investing and Financing Transactions</i>		
Capital Lease Obligation Incurred (Terminated) for Use of Equipment	\$ 22,540	\$ (80,867)
Total Non-Cash Transactions	<u>\$ 22,540</u>	<u>\$ (80,867)</u>

The accompanying notes are an integral part of these financial statements.

**FEDERAL HOUSING FINANCE BOARD
NOTES TO THE FINANCIAL STATEMENTS
SEPTEMBER 30, 2004 and 2003**

Note 1 *Organization and Nature of Business*

The Federal Housing Finance Board (Finance Board) is an independent non-appropriated funded Agency in the Executive Branch. The Finance Board ensures that the Federal Home Loan Banks (FHLBanks), which are privately capitalized, government-sponsored enterprises, operate in a safe and sound manner, carry out their housing and community development finance mission, and remain adequately capitalized and able to raise funds in the capital markets. The FHLBank System raises its money through the Office of Finance that acts as the central debt issuance facility for all 12 FHLBanks.

The FHLBank System was created in 1932 to promote home ownership and a strong home-finance industry. It is a network of 12 district banks that provide lending, deposit, and other services to mortgage-lending institutions. The members of the FHLBank System originate and hold a significant portion of the nation's home mortgages. Membership includes the thrift institutions, commercial banks, credit unions, and a small number of insurance companies.

Each Federal Home Loan Bank and the Office of Finance operates with its own staff and funding. Accordingly, the accompanying financial statements summarize only the financial activities of the Finance Board.

The Finance Board is located in Washington, DC, where it operates with a staff of just over 100 employees under the direction of a five member Board of Directors, four of whom are appointed from the private sector by the President. The fifth is the Secretary of Housing and Urban Development or his designee. Operation of the Finance Board is funded by the collection of assessments from each of the Federal Home Loan Banks. These assessments are used to fund the salaries and expenses of staff engaged in supervision and compliance activities, planning and policy development, strategic planning, and administration.

Note 2 *Summary of Significant Accounting Policies and Practices*

Basis of Presentation: The accompanying financial statements have been prepared on an accrual basis, consistent with accounting principles generally accepted in the United States of America.

Cash Receipts and Disbursements: Cash is received in and disbursed from an account in the U.S. Treasury established for the Finance Board's sole use.

Significant receipts are those transmitted to this account monthly by the 12 Federal Home Loan Banks which are assessed amounts necessary to cover the Finance Board's expected operating needs for the fiscal year.

Disbursements are made as necessary to fund the biweekly payroll and administrative costs of the organization. Because of the nature of the Finance Board's program, disbursements do not vary significantly from one month to the next.

Effective October 1, 2002, the Finance Board commenced processing its financial transactions in-house using the PeopleSoft Financial Management for Education and Government financial management system. Prior to October 1, 2002, the Finance Board utilized the accounting services of the Department

**FEDERAL HOUSING FINANCE BOARD
NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 2004 and 2003**

Note 2 Summary of Significant Accounting Policies and Practices (continued)

of Agriculture's National Finance Center. The National Finance Center continues to process and pay payroll-related costs for the Finance Board.

Prepaid Expenses: Prepaid expenses are held to a minimum. The only significant recurring prepaid expense is the rent payment for the Finance Board's office space at 1777 F Street, N.W.

Note 3 Property and Equipment

Equipment acquisitions greater than or equal to \$5,000 are capitalized and depreciated using the straight-line method over the estimated useful lives of the assets, with a salvage value of \$100. Additionally, for bulk purchases of similar items which individually do not meet the test for capitalization, the acquisition is capitalized and depreciated if the depreciated basis of the bulk purchase is \$5,000 or more.

Property and Equipment consisted of the following at September 30:

	<u>2004</u>	<u>2003</u>
Equipment and Internal-Use Software	\$6,144,166	\$6,420,629
Accumulated Depreciation	<u>(4,275,295)</u>	<u>(3,458,798)</u>
Equipment and Internal Use Software, net	\$1,868,871	2,961,831
Leasehold Improvements	490,485	456,901
Accumulated Amortization	<u>(301,014)</u>	<u>(219,668)</u>
Leasehold Improvements, net	<u>189,471</u>	<u>237,233</u>
Total Property and Equipment, net	<u>\$2,058,342</u>	<u>\$3,199,064</u>

Note 4 Employee Benefit Programs

Retirement: The Finance Board's non-temporary employees are covered by one of two retirement programs. The Civil Service Retirement System (CSRS) covers those employees who were employed by the Federal Government prior to January 1, 1984. All other non-temporary employees are covered by the Federal Employees Retirement System (FERS), a retirement program created for federal employees hired after this date.

CSRS and FERS are multi-employer plans. Employees changing agencies within the Federal Government retain the credit they earned in prior federal employment. The two plans differ in key respects. CSRS is a defined benefit plan, and future retirement distributions are funded by the Office of Personnel Management (OPM) as well as by employer and employee contributions. FERS is a defined contribution plan, fully funded by employer and employee contributions.

Approximately 23% of the Finance Board's employees are covered by CSRS (regular) and CSRS-Offset pension plans. For CSRS (regular) employees, the Finance Board withheld 7.0% of their adjusted base

**FEDERAL HOUSING FINANCE BOARD
NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 2004 and 2003**

Note 4 Employee Benefit Programs (continued)

pay in the most recent year and the agency contributed 7.0%. This combined sum was transferred to OPM's Civil Service Retirement Fund, to be matched with OPM's contribution as benefits are paid out to members of this employee group in their retirement years. The CSRS-Offset is a variation of the CSRS plan, in that it applies to CSRS-vested employees who had a break in continuous service of over one year after January 1, 1984. CSRS-Offset employees received the same agency contributions noted above, but the Finance Board's salary withholding of 7.0% was distributed to both the social security fund (6.2%) and the CSRS fund (.8%) up to the 2004 FICA maximum wage level of \$87,900. Thereafter, for each additional dollar of salary, the Finance Board withheld 7.0% and transferred it entirely to the Civil Service Retirement Fund. This CSRS-Offset employee group will receive retirement benefits from both the Civil Service Retirement Fund and Social Security System.

The remainder of the Finance Board's employees is covered by FERS, having been hired by the Federal Government since January 1, 1984. For such employees, the Finance Board contributed 10.7% of the employee's adjusted annual salary and a .8% employee share to the FERS pension fund. Additionally, the Finance Board withheld 6.2% of the employee's salary for the social security fund.

FERS employees receive an annuity that is drawn from not only the Social Security System and FERS pension fund, but also from the employer's contribution of a minimum of 1% of the employee's salary annually to the Thrift Savings Plan (TSP). Employees under both CSRS and FERS can augment their retirement income through contributions to the TSP. Through fiscal year 2004, CSRS employees were able to contribute, on a tax-deferred basis, up to 9% of their annual salary to this federally-managed investment fund. FERS employees were able to contribute up to 14% of their annual salary, which the Finance Board matched up to 5%.

The Finance Board's fiscal year 2004 contributions to the CSRS and FERS funds were \$1,133,577 and its contribution to the TSP was \$412,034. The fiscal year 2003 contribution for the CSRS and FERS retirement programs was \$1,105,743 and the TSP contribution was \$420,874.

The Finance Board has no liability for future payments to retirees under these defined-benefit retirement programs and is not accountable for the assets of the plan. OPM administers the retirement funds and provides any supplemental money needed to fund retiree annuities. The Federal Retirement Thrift Investment Board manages the TSP.

Accrued Leave: Finance Board employees are entitled to accrue annual leave and sick leave at a rate based on their years of federal service. For most employees, annual leave may be accrued up to 240 hours each year. Senior employees may accrue annual leave consistent with the rules for SES level employees. Any unused balance is paid to the employee upon leaving federal service, based on the employee's earnings per hour. There is no maximum limit on the amount of sick leave that may be accrued. Upon separation, any unused sick leave of CSRS plan employees is creditable as additional time in service for the purpose of calculating an employee's retirement annuity. For FERS plan employees, unused sick leave is held indefinitely and may be used if rehired.

Health Benefits and Life Insurance: The Finance Board, through programs established for all agencies by the Federal Government, offers its employees health and life insurance coverage. The cost of each is

**FEDERAL HOUSING FINANCE BOARD
NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 2004 and 2003**

Note 4 Employee Benefit Programs (continued)

shared by the Finance Board and its employees. The Finance Board's fiscal year 2004 contribution to health and life insurance coverage was \$620,863. The fiscal year 2003 contribution was \$479,276. In addition, all employees have 1.45% of their gross earnings withheld to pay for future Medicare coverage.

Note 5 Leases

Operating Lease: The Finance Board leases office space under a non-cancelable long-term lease that expires on December 24, 2006, and requires monthly payments of \$132,361. Total rental payments for fiscal years 2004 and 2003 were \$1,588,327 and \$1,588,327, respectively. The minimum future payments, as required by the lease, are as follows:

Year ending September 30:

2005	\$1,588,327
2006	1,588,327
2007	<u>397,082</u>
Total	<u>\$3,573,736</u>

The Finance Board has an agreement to sublet certain office space. The payments to be received from its tenant through September 30, 2005, total \$18,000. The agreement to sublet space is entirely contingent upon the Finance Board continuing to maintain its rights to possession of its premises pursuant to the lease.

Capital Leases: The Finance Board leases copiers under lease-to-own agreements. The lease terms range from 54 to 60 months. The minimum future lease payments and the present value of the net minimum lease payments are as follows:

Year ending September 30:

	2005	\$33,016
	2006	32,100
	2007	5,493
	2008	5,493
	2009	<u>458</u>
Total Future Minimum Lease Payments		76,560
Less: Imputed Interest		<u>(8,448)</u>
Present Value of the Net Minimum Lease Payments		68,112
Less: Current Portion		<u>(27,844)</u>
Lease Obligation-Long Term		<u>\$40,268</u>

**FEDERAL HOUSING FINANCE BOARD
NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 2004 and 2003**

Note 6 *Net Position*

The net position of the Finance Board, as of September 30, is composed of the following:

	<u>2004</u>	<u>2003</u>
Investment in Fixed Assets, Net of Lease Obligations	\$1,990,230	\$3,129,611
Designated to Reduce Future FHLBank Assessments*	<u>6,974,616</u>	<u>5,338,338</u>
Total Net Position	<u>\$8,964,846</u>	<u>\$8,467,949</u>

* The amounts identified are the year end unexpended balances used to offset future (next Fiscal Year) billings to the Federal Home Loan Banks.

Note 7 *Assessments of Federal Home Loan Banks*

The FHLBanks collectively are assessed amounts needed to fund the Finance Board's annual budget, which is approved by the Finance Board's Board of Directors prior to the start of a new fiscal year. Each FHLBank's share is based upon the dollar value of its capital stock relative to the combined dollar value of all FHLBanks' capital stock. The Finance Board's expenses are met through assessments paid by the FHLBanks that totaled \$25,744,343 and \$22,455,512 for the years ended September 30, 2004 and 2003, respectively.

Note 8 *Contingent Liabilities*

Equal Employment Opportunity Commission (EEOC): As of the year ended September 30, 2004, there were two EEOC cases with potential losses ranging from \$0 to \$300,000. On July 14, 2004, the EEOC dismissed one case and on October 8, 2004, the EEOC affirmed the dismissal. The case now is closed. On October 8, 2004, the EEOC dismissed the second case. An appeal of the dismissal of the second case is considered unlikely.

United States District Courts: As of the year ended September 30, 2004, there were two civil actions pending in federal district courts. On June 7, 2004, one case was transferred from the U.S. District Court for the District of Columbia to the District of Kansas. The case has not yet been docketed in the District of Kansas. This case has a potential loss ranging from \$0 to \$100,000. An unfavorable outcome is considered unlikely. On March 16, 2004, the second case was filed in the U.S. District Court for the District of Columbia. The Finance Board intends to file a dispositive motion to dismiss the case and/or for summary judgment. This case has a potential loss ranging from \$0 to \$300,000. An unfavorable outcome is considered unlikely.



BROWN & COMPANY CPAs, PLLC

CERTIFIED PUBLIC ACCOUNTANTS AND MANAGEMENT CONSULTANTS

**INDEPENDENT AUDITOR'S REPORT ON
INTERNAL CONTROL OVER FINANCIAL REPORTING**

Office of Inspector General
Board of Directors
Federal Housing Finance Board
Washington, D.C.

We have audited the financial statements of the Federal Housing Finance Board (the Finance Board) as of and for the year ended September 30, 2004, and have issued our report thereon dated October 28, 2004. We conducted our audit in accordance with auditing standards generally accepted in the United States of America, and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

In planning and performing our audit, we considered the Finance Board's internal control over financial reporting by obtaining an understanding of the Finance Board's internal control, determined whether internal controls had been placed in operation, assessed control risk, and performed tests of controls in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements. The objective of our audit was not to provide assurance on internal control. Consequently, we do not provide an opinion on internal control.

Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be reportable conditions. Under standards issued by the American Institute of Certified Public Accountants, reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of the internal control that, in our judgment, could adversely affect the Finance Board's ability to record, process, summarize, and report financial data consistent with the assertions by management in the financial statements. Material weaknesses are reportable conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Because of inherent limitations in internal controls, misstatements, losses, or non-compliance may nevertheless occur and not be detected. However, we noted no matters involving the internal control and its operation that we considered to be material weaknesses as defined above.

During the course of our audit we noted a matter involving internal control and its operation that we have reported to management of the Finance Board in a separate management letter dated October 28, 2004.

This report is intended solely for the information and use of the management of the Federal Housing Finance Board, OMB, and Congress, and is not intended to be and should not be used by anyone other than these specified parties.

Brown & Company

Largo, Maryland
October 28, 2004

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10

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**INDEPENDENT AUDITOR'S REPORT ON
COMPLIANCE WITH LAWS AND REGULATIONS**

Office of the Inspector General
Board of Directors
Federal Housing Finance Board
Washington, D.C.

We have audited the financial statements of the Federal Housing Finance Board (the Finance Board) as of and for the year ended September 30, 2004, and have issued our report thereon dated October 28, 2004. We conducted our audit in accordance with auditing standards generally accepted in the United States of America, and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

The management of the Finance Board is responsible for complying with laws and regulations applicable to the Finance Board. As part of obtaining reasonable assurance about whether the Finance Board's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts.

Providing an opinion on compliance with certain provisions of laws and regulations was not an objective of our audit, and, accordingly, we do not express such an opinion. However, we noted no noncompliance with laws and regulations, which could have a direct and material effect on the determination of financial statement amounts.

This report is intended solely for the information and use of the management of the Finance Board, OMB, and Congress, and is not intended to be and should not be used by anyone other than these specified parties.

Brown & Company

Largo, Maryland
October 28, 2004

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